



# muswellbrook shire council

## DRAFT Borrowing Policy

MSC13E

### Authorisation Details

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Community Strategic Plan Goal	6. Collaborative and responsive community leadership that meets the expectations and anticipates the needs of the community.		
Community Strategic Plan Strategy	6.2 Ensure Council is well managed, appropriately resourced, effective, efficient, accountable and responsive to its communities and stakeholders.		
Delivery Program activity	6.2.1 Maintain a strong focus on financial discipline to enable Council to properly respond to the needs of the communities it serves.		

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# 1 Policy Objective

This policy sets out Muswellbrook Shire Council's (Council's) loan borrowing requirements, both internal and external, and the use of any overdraft facility, with consideration given to the following primary objectives:

- Ensure that all borrowings (both internal and external) are in accordance with relevant legislative provisions.
- Ensure the total amount of the loan borrowings is sustainable in terms of Council's ability to meet future repayments and budgetary obligations.
- To detail Council's planned financial management strategy for existing and future debt.
- Minimise the cost of borrowing.
- Meeting industry best practice in respect to Council's Debt Service Ratio.
- Have regard to the long term and cumulative effects of Council's decisions.
- Exercise reasonable care and diligence that a prudent person would exercise when borrowing funds.

## 2 Risks being addressed

### 2.1 Risks Addressed by the Borrowing Policy:

- Ensures borrowing aligns with the council's capacity to repay within a sustainable financial framework.
- Prevents excessive debt levels that could jeopardise long-term financial sustainability.
- Ensures the council maintains sufficient liquidity to meet its financial obligations, including loan repayments and operational expenses.
- Ensures compliance with the *Local Government Act 1993* (NSW) and relevant guidelines, such as the Office of Local Government's (OLG) Capital Expenditure Guidelines.
- Provides strategies for managing fixed vs. variable interest rate loans to minimise financial exposure from fluctuating interest rates.
- Promotes proper decision-making, transparency, and accountability in borrowing decisions.
- Minimises the risk of mismanagement or unauthorised borrowing.

### 2.2 Risks of Not Complying with the Policy:

- Non-compliance could lead to excessive debt accumulation, impacting the council's ability to fund essential services and projects.
- Potential cash flow issues may result in the council being unable to meet its financial obligations.
- Breaching the *Local Government Act* or failing to adhere to regulatory requirements may result in penalties, audits, or legal disputes.
- Non-compliance and mismanagement of borrowed funds could erode public trust in the Council's governance and financial stewardship.

- Poor borrowing decisions or failure to secure competitive rates may lead to higher costs, reducing funds available for community projects.
- Non-compliance with financial policies could harm the Council's reputation and limit its ability to access favourable credit terms in the future.

## 2.3 Why Do We Have This Policy?

- To comply with the Ministerial Revised Borrowing Order and the *Local Government Act 1993* (NSW), which mandates councils to manage their financial resources responsibly and transparently.
- To ensure borrowing decisions are made within a framework of sustainability, supporting long-term financial health while delivering infrastructure and community services.
- To establish clear processes and responsibilities for borrowing, ensuring transparency and accountability in decision-making.
- To demonstrate sound financial management, reinforcing public confidence in the council's ability to manage resources effectively.
- To ensure borrowing supports the delivery of strategic objectives, such as funding critical infrastructure and community development projects.

# 3 Policy Statement and Scope

## 3.1 Principles

Borrowings are not a form of revenue and do not replace the need for Council to generate sufficient operating revenue to service its operating requirements.

Council aims to finance capital works and new assets to the greatest extent possible from revenue, grants, subsidies or any specific reserves primarily established to fund capital works.

It is Council's aspiration to fund depreciation, and restrict those funds into an internal reserve, for the purpose of funding capital works.

Existing assets, that are due for renewal are to be replaced from the funding of depreciation costs, except for "lumpy" assets, where borrowing may be used, and the funded depreciation used to repay the loan, both principal and interest.

Council will not enter any financing arrangements which involve the repayment of interest only.

Council will restrict all borrowings to expenditure on identified capital projects that are considered by Council to be of the highest priority, and which are unable to be funded from revenue. Under no circumstances will Council borrow funds for recurrent expenditure.

New assets, that are income producing, may be funded from debt.

Where a capital project for a service that is funded by user charges (e.g. waste, water or sewer) is determined to be funded by way of loans, the user charge should reflect the cost of providing the service (including any loan repayments).

Other specific capital projects, not funded by user charges, will only be considered for loan funding where the project is considered by Council to be beneficial to most ratepayers.

Financing of major infrastructure assets requires a strategic approach to evaluate the risk exposure to Council.

In considering the impact of borrowing on council's budget, council will be guided by:

- The Long-Term Financial Plan resourcing the Community Strategic Plan.
- The relevant Asset Management Plan or Integrated Water Cycle Management Plan informing the Community Strategic Plan.
- Achieving the benchmark Operating Result Ratio.
- Achieving the benchmark Asset Renewal Ratio.
- Debt service ratios.

## 3.2 Scope

The following provides some context for the above principle points.

### When to use debt?

The use of debt is linked to the concept of intergenerational equity. Operating and asset renewal expenses should be paid by current residents and therefore current revenue. Expenditures that provide benefits over many years should be paid for by users that benefit from the works over its economic life. This cannot be achieved by accumulating current revenues for future expenditure but is achieved by using current revenues to fund loan repayments over the life of the asset.

Debt is also appropriate where the expenditure results in a reduction of operating costs or an increase in operating revenues that cover the cost of borrowing. There may also be emergency situations where works are required urgently to avoid significant risks or escalations in remediation costs.

### How will a project be approved for funding?

Assessment of a project will follow Council's Investment Logic Mapping process, and incorporate the following mandatory analysis:

- Council Priorities - Does the project outcome support an objective of Council's Strategic Priorities?
- Community Expectations - The project outcome must align to an action adopted under the Community Strategic Plan and Council's Delivery Program.
- Asset Management - Is the expenditure programmed in the appropriate Asset Management Plan adopted by Council under the integrated planning and reporting provisions of the *Local Government Act*? Will the project contribute to Council maintaining its Asset Renewal Ratio at or above the industry Asset Renewal Ratio benchmark?
- Financial Management - Have the operating and capital cost of a project been accurately assessed and included in Council's Long Term Financial Plan to determine the financial impact of a project and the capacity for Council to maintain a positive Operating Performance Ratio?
- Risk Management - All projects shall be evaluated under the Project Risk Assessment Matrix and identified risks will be mitigated or managed as documented in the risk assessment.

- Debt affordability - Debt is affordable where the works are self-funding either from reduced operating costs or an increase in revenues or the net result of both. Alternatively, debt is only affordable if the relevant fund has an operating surplus sufficient to cover the loan repayments. Operating revenues should be able to cover cash operating expenses as well as non-cash accruals for leave entitlements, depreciation and remediation, before committing to loan repayments, for the fund to be financially sustainable. The fund is required to maintain a positive Operating Result Ratio to achieve industry benchmarks.
- Appropriate sources and terms of debt - The Office of Local Government will set controls for borrowings which may change at any time and Council needs to keep aware of these through the related legislation and references below. Council will not indulge in speculative debt arrangements and will adhere to standard table loans with set monthly, quarterly or bi-annual instalments and rates fixed for at least five years. Repayment periods will not exceed the economic life of the works to ensure intergenerational equity.

### 3.3 External Loans

In considering the need for new loans, the following criteria will be analysed:

- Any proposed borrowing amounts must be contained in Council's Long Term Financial Plan, Delivery Program and Operational Plan.
- Current and estimated future revenues - Where possible loans should only be raised for income producing products, however this will not apply to non-income generating assets such as roads and stormwater drainage, these works will only be considered if the project can demonstrate long term savings by bringing works forward.
- Strategic planning for the future of the Council covering short, medium and long term.
- Inter-generational equity considerations in terms of ratepayers who benefit from the expenditure and, therefore, on a user pay basis, who should pay for the costs associated with such expenditure.
- Current and future funding needs for both operating and capital expenditures.
- Potential movements in interest rates and associated debt servicing costs.
- Ensure, where possible, that the structure of the borrowing is appropriate for the nature of the asset being funded.
- Any other strategic imperative that is linked to revenue and expenditure capacities.

### 3.4 Terms of Loans

The term of the loan should not exceed the expected economic life of the asset being funded, subject to the maximum periods below.

Borrowing Amount	Term
\$500,000 to \$1,000,000	Maximum 5 years
\$1,000,000 to \$2,000,000	10 years
\$2,000,000 to \$5,000,000	20 years
Greater than \$5,000,000	30 years

### 3.5 Determination of Appropriate Lending Institution

Once borrowing has been approved by Council, within its Delivery Plan, Operational Plan and annual budget, a quotation process will be conducted whereby appropriate lending institutions (ADIs) will be invited to submit written quotations on Council's borrowing requirements.

Quotations/Tenders will be sought from ADIs with a long-term credit rating of A- or above in order to determine the appropriate lending institution for any new or renewal loan borrowings.

Written quotations/tenders must include:

- Interest rate - may be fixed or variable for the term of the loan;
- Term of the loan;
- Repayment intervals (monthly, quarterly or bi-annually);
- Repayment instalment amount (principal and interest only);
- Any applicable fees;
- Appropriate and acceptable documentation must be provided to Council by any prospective lender during the quotation/tender process; and
- The calculation for any loan break costs must be clearly set out in the loan documentation.

As Muswellbrook Shire Council has been deemed "Fit" under the NSW Government Local Government Reforms, Council is able to access the Statement Government borrowing facility. This borrowing facility is managed by NSW Treasury Corporation (TCorp). The minimum TCorp loan is \$1,000,000 and Council would also need to meet TCorp's rules in relation to its investment portfolio credit rating breakdown across the financial institutions it invests with.

### 3.6 Borrowing Authorisation

The authority to authorise loans and/or Council funding requirements is vested with Council by virtue of the *Local Government Act, 1993*. No officer of Council is authorised to undertake the establishment of a new loan facility without the authorisation of Council.

Council must have resolved to borrow funds as part of its Delivery Plan, Operational Plan, emergency circumstances and annual budget, before funds are borrowed.

The General Manager has the authority to accept loan offers, subject to the borrowing amount being previously approved by Council and the requirements of this policy being adhered to.

Council will be advised of the terms of the loan once finalised.

The Borrowings Return form must be submitted to The Office of Local Government (OLG) by July each year, outlining Council approved loan borrowings for the following financial year.

The Finance team will periodically review the debt portfolio to ascertain if there is an opportunity for refinancing which will deliver positive outcomes to Council.

### 3.7 Legislative Authority for Investments

The following legislation or guidelines are relevant to Councils when considering loan borrowing

- Local Government Act 1993



- Local Government (General) Regulation 2021
- Minister's Borrowing Order
- NSW TCorp Loan Facilities Guides for Local Councils September 2019

### 3.8 Limitations

Current borrowing restrictions are prescribed in the Local Government Borrowing Order which states:

*A council shall not borrow from any source outside the Commonwealth of Australia nor in any other currency other than Australian currency.*

Council has also determined that in addition to this the following limitations will apply:

- That the total amount of borrowings outstanding assets, excluding the Future Fund, is not to exceed 2.5 times the total amount of Ordinary Rates, including Special Rates and Annual Charges, in any one year, and
- That the total amount of borrowings is not to exceed a Debt Service Ratio of 20% (as disclosed in the Fit for the Future documentation).

### 3.9 Internal Borrowing

#### From Externally Restricted Funds

Internal loans from externally restricted funds do not need to be included in the Office of Local Government (OLG) "requested borrowing" return. Internal loans from externally restricted funds must have Ministerial approval before the internal loan can be drawn.

Section 410(3) of the *Local Government Act, 1993* NSW states:

*"Money that is not yet required for the purpose for which it was received may be lent (by way of internal loan) for use by the council for any other purpose if, and only if, its use for that other purpose is approved by the Minister."*

#### From Internally Restricted Funds

The use of internally restricted funds is not considered to be an internal loan by the OLG. The use of internally restricted cash for a purpose that is different from its original purpose requires a resolution of Council.

Council has determined funds can be borrowed from Internally Restricted Reserves as a replacement for an external loan borrowing, on the basis:

- That the interest rate to be charged is pegged at 0.25% below the external rate
- Funds can be borrowed internally, within the Section 7.11 Reserve, only for the purpose of other Section 7.11 works and cannot be used to fund works that are not part of the Section 7.11 works schedule

### 3.10 Borrowing Redemption

When surplus funds exist, the decision to repay borrowings shall be made on the facts available at the time with consideration of impact on Council's Long Term Financial Plan and giving due regard to minimising the overall cost to the organisation.

Loans will only be paid out early if there is a significant net financial benefit to Council.



### 3.11 Overdraft

Council has an overdraft facility of \$750,000 established with Westpac Banking Corporation.

The overdraft facility is only used for short term unavoidable and essential cash flow purposes.

Council's finance staff will generally avoid the use of the overdraft facility via careful cash management practices that ensures sufficient funds are available to fund daily expenditure requirements.

### 3.12 Compliance and Monitoring

A reconciliation of all borrowings, including the weighted average interest rate of borrowings and accrual of interest, will be completed by the Responsible Accounting Officer and reported quarterly to the Finance Committee.

## 4 Dispute Resolution

The General Manager is the interpreter of this policy and shall be the sole arbiter in respect to the application of this policy.

## 5 Related Documents

### 5.1 Legislation and Guidelines

- Australian Accounting Standards
- NSW Office of Local Government – Local Government Code of Accounting Practice & Financial Reporting
- NSW Office of Local Government Borrowing Circulars
- NSW Office of Local Government Capital Expenditure Guidelines
- Local Government (General) Regulation 2021
- Local Government Act 1993
- Minister's Borrowing Order (gazetted)

### 5.2 Policies and Procedures

- Code of Conduct
- Financial Management Policy
- Procurement Policy
- Disciplinary Policy & Procedures
- Internal Reporting Public Interest Disclosures Policy
- Fraud and Corruption Prevention Strategy

### 5.3 Other Supporting Documents

- N/A

## 6 Definitions

Term	Meaning
Annual charges	Has the same meaning as determined by the Local Government Act.
Asset renewal ratio	$\frac{\text{Asset Renewals}}{\text{Depreciation, Amortisation \& Impairment Expense}}$ <p>This ratio measures Council's ability to renew assets at a rate equivalent to or greater than the consumption expense of Council's assets each year. Industry benchmarks require a ratio of 1 or above.</p>
Borrowing	Cash received from another party in exchange for future payment of the principal, interest and other finance charges.
Borrowing costs	Interest and other costs that an entity incurs in connection with the borrowing of funds.
Borrowing facility	A loan that is not drawn down (borrowed against) completely when approved but allows for a series of timed borrowings, over a period of time, up to the maximum of the facility. These are generally used for property development.
Debt service ratio	<p>The debt service cover ratio is calculated as:</p> $\frac{\text{Operating result before capital excluding interest and depreciation/impairment/amortisation}}{\text{Principal repayments (Statement of Cash Flows) plus borrowing costs (Income Statement)}}$ <p>This ratio measures the availability of operating cash to service debt including interest, principal and lease payments (The OLG consolidated key performance indicator is greater than 2)</p>
Emergency circumstances	An unforeseen, serious, unexpected or dangerous situation requiring immediate action.
External borrowings	Includes raising and obtaining, in any way, money, credit and other financial accommodations from sources external to Council.
Loan break costs	Costs associated with paying out a loan prior to the loan expiry date.
Loan facility	A line of credit providing access to borrow money up to a particular amount.
Long term credit rating	A forward-looking opinion about credit risk, by a recognised and reputable rating agency, as allowed under the Ministerial Investment Order.
Long Term Financial Plan	Council's Ten (10) year budget maintained in its resourcing strategy in accordance with Section 403 Local Government Act, 1993
Lumpy assets	Assets that when due for renewal will require funding that is greater than two years of renewal funding for those assets, as defined in the Asset Management Plan (AMP) and Sub-Plans. An example would be replacing the roof on a building.

Term	Meaning
Operating result ratio	$\frac{\text{Operating Revenue excluding Capital grants \& Contributions less Operating Expenses}}{\text{Operating Revenue excluding Capital grants \& Contributions}}$ <p>This ratio measures Council's achievement of containing operating expenditure within operating revenue. The industry benchmark is greater than or equal to break even average over three years.</p>
Ordinary rates	Has the same meaning as determined by the <i>Local Government Act</i> .
Overdraft facility	A flexible line of credit providing access to funds to manage the day-to-day cash flow needs of an organisation
Security	In accordance with the <i>Local Government Act</i> , security for any loan will only be given over the future Ordinary Rates of Council.
Renewal funding	The annual amount of funding that is required to be raised and held, that is equivalent to straight line depreciation of the total value of the asset over the useful life of the asset, being the renewal intervention life. For roads it is 45 years, whilst 50 years is considered the failure point.
Variable interest	Interest that fluctuates over the life of the loan and is usually pegged to a benchmark rate, such as the bond rate.

## 7 Version History

Version No.	Date changed	Modified by	Amendments made
1.	05/04/2022	Council Minute no 279	Adopted 05/04/22 minute number 279. Public Exhibition from 6/04/22 for 28 days, no submissions received therefore adopted by Council on 05/04/22.
2	02/12/2024	CFO, and Financial Controller	Reviewed for new Council Term 2024-2028.